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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

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SEP 10 2002

Control Number ED-OIG/A05-C0020

Mr. Wayne Godwin
Executive Vice President & Chief Operating Officer
Public Broadcasting Service
1320 Braddock Place
Alexandria, VA 22314

Dear Mr. Godwin:

This **Final Audit Report** presents the results of our audit of the Public Broadcasting Service's (PBS) administration of the Ready-To-Learn Cooperative Agreement No. R295A000002 (Agreement) awarded under the Department of Education's Ready-To-Learn Television program for the period September 1, 2000, through August 31, 2001. Our objective was to determine whether costs charged to the Agreement were allowable, reasonable, and allocable in accordance with the Elementary and Secondary Education Act of 1965 (ESEA), as amended, Agreement terms, Education Department General Administration Regulations (EDGAR), and the cost principles in Office of Management and Budget (OMB) Circular A-122.

We provided a draft of this report to PBS. PBS agreed with the findings and recommendations, except that it disagreed with all or part of unsupported salaries, fringe benefits, business meals, indirect costs, and rent and utilities costs. After reviewing PBS's response, we concluded that we could reclassify salaries and related fringe benefits as recommended for acceptance because PBS provided a supporting timesheet. PBS provided adequate documentation to support reclassifying \$591 of business meals as recommended for acceptance. For the remaining disputed costs, PBS did not provide sufficient support to cause us to reclassify these costs as recommended for acceptance. We have summarized PBS's comments after each finding, and have included the response transmittal letters as Attachment 2.

AUDIT RESULTS

PBS generally complied with the ESEA, Agreement terms, EDGAR, and the cost principles in OMB Circular A-122 in administering the Agreement. However, as discussed in the findings, PBS charged the Agreement for unallowable costs (\$52) or for costs it did not adequately support (\$140,664), and did not have adequate written policies and procedures for administering the Agreement.

Finding No. 1 PBS Charged Costs to the Agreement that are Unallowable or Unsupported

PBS charged costs to the Agreement that are unallowable (\$52) or unsupported (\$140,664). The unallowable amount consists of charges for alcoholic beverages (\$48) and related indirect costs (\$4). The unsupported amount consists of charges for meals (\$1,122), indirect costs (\$93,927), and rent and utilities (\$45,615) for which it did not provide adequate documentation to support that the costs were reasonable, allowable, or allocable.

OMB Circular A-122, *Cost Principles for Non-Profit Organizations, Attachment A, General Principles, Paragraph A, Subparagraphs A.2.a and A.2.g.* (1998) provides that—

To be allowable under an award, costs must...Be reasonable for the performance of the award and be allocable thereto...Be adequately documented.

Details are discussed in the Attachment.

Recommendations

We recommend that the Assistant Secretary for the Office of Educational Research and Improvement instruct PBS to—

- 1.1 Refund to the Department of Education unallowable costs of \$52; and
- 1.2 Provide sufficient documentation to support \$140,664 or refund that amount to the Department of Education.

Auditee Comments

PBS concurred with the questioned costs. It did not concur with unsupported salaries (\$1,737), related fringe benefits (\$482), business meals (\$1,494), indirect costs (\$93,909), and rent and utilities (\$45,615). PBS provided a timesheet to support the salaries. Based on the timesheet documenting the salary costs, it asserted that related fringe benefits and indirect costs also are allowable. PBS provided various documents that it asserted supported most of the unsupported business meals. Also, PBS stated that, because it had submitted an indirect cost proposal to the Department of Education that proposed an indirect cost rate of 12.35 percent, it disagreed that indirect costs claimed at 8 percent are unsupported. PBS also stated that its methodology of allocating rent and utilities based on salaries was consistent with the corporate methodology used at the time. Since then, PBS has changed its methodology to be based on headcount versus salaries charged. It provided an analysis for the fiscal year 2003 budget period that showed

allocating rent and utilities based on headcount is materially consistent with allocating them based on square footage.

Auditor Response

We reviewed PBS's response and have reclassified the unsupported salaries and related fringe benefits as recommended for acceptance. We also concluded that, for business meals, PBS provided adequate documentation to support \$591 of the \$1,494 it disagreed with, so we reclassified \$591 as recommended for acceptance. We have not changed our conclusion regarding the remaining business meals costs, indirect costs, and rent and utilities. Until the Department of Education negotiates a final rate with PBS, we have no basis for agreeing with PBS's assertion that its proposed 12.35 percent rate will result in a negotiated rate greater than the 8 percent rate it used. With respect to rent and utilities, we agree that its analysis shows that a headcount allocation is materially consistent with a square footage allocation. However, PBS did not use either of these methods to allocate rent and utilities costs. Instead PBS allocated them based on salaries. In its response, PBS did not provide any documentation to support that the salary allocation was materially consistent with a headcount or square footage allocation.

Finding No. 2 PBS Needs to Establish and Implement Written Policies and Procedures that Comply with the Standards for Financial Management Systems

PBS does not have written policies and procedures for financial management.

The standards for financial management systems are contained in 34 C.F.R. § 74.21. The standards specify various requirements of a financial management system that recipients must provide that include—

- Effective control over and accountability for all funds, property, and other assets. Recipients shall adequately safeguard all assets and assure they are used solely for authorized purposes. 34 C.F.R. § 74.21(b)(3) (2000).
- Written procedures for determining the reasonableness, allocability, and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award. 34 C.F.R. § 74.21(b)(6) (2000).
- Accounting records including cost accounting records that are supported by source documentation. 34 C.F.R. § 74.21(b)(7) (2000).

Because PBS did not have written policies and procedures that complied with the standards for financial management, PBS incurred costs that were unallowable. Also, PBS did not always have source documents to support that costs incurred were reasonable, allocable, and allowable (see Attachment).

Recommendation

We recommend that the Assistant Secretary for the Office of Educational Research and Improvement instruct PBS to—

- 2.1 Develop and implement written policies and procedures that comply with the standards for financial management. (Note: We made this same recommendation in Finding No. 2 in audit report ED-OIG/A05-C0011.)

Auditee Comments/Auditor Response

PBS stated that, effective April 1, 2002, it developed written policies and procedures for financial management. PBS provided training to the staff on those policies and procedures on April 5, 2002. It appears that the policies and procedures comply with the standards for financial management.

Finding No. 3 PBS Needs to Revise Its Travel Policy

PBS's travel policy does not address at least one requirement contained in the cost principles.

OMB Circular A-122, *Cost Principles for Non-Profit Organizations, Attachment B, Selected Items of Cost, Paragraph 2* (1998) provides that—

Costs of alcoholic beverages are unallowable.

PBS employees purchased alcoholic beverages, and PBS charged the costs to the Agreement as travel expenses. We recognize that the unallowable costs we specifically identified were not significant. However, without a written policy statement notifying employees that costs of alcoholic beverages are not allowable, it is likely that they will continue to claim and be reimbursed for such costs. As a result, federal funds intended for activities that benefit the Agreement will, instead, be used for unallowable activities.

Recommendation

We recommend that the Assistant Secretary for the Office of Educational Research and Improvement instruct PBS to—

- 3.1 Revise its travel policy to ensure that it includes all applicable cost principles. (Note: We made this same recommendation in Finding No. 4 in audit report ED-OIG/A05-C0011.)

Auditee Comments/Auditor Response

PBS stated that it revised its travel policy to ensure that it includes all applicable cost principles, including the prohibition of alcoholic beverages. It appears the revised policy is adequate.

OTHER MATTERS

Our review of 14 procurements valued over \$25,000 each disclosed that PBS did not obtain competitive bids for 5 procurements. In addition, PBS named three other vendors in its Agreement proposal for which it did not obtain competitive bids. According to 34 C.F.R. § 74.43, "All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition." While we did not determine if PBS paid more for the procurements because it did not competitively bid them, a lack of competitive bidding can result in less than optimum price, quality, or other factors. Subsequent to our on-site fieldwork, PBS developed a policy for its federal programs that requires competitive bids on all procurements over \$25,000.

BACKGROUND

PBS, headquartered in Alexandria, Virginia, is a private, non-profit media enterprise incorporated in 1969 that is owned and operated by the nation's 348 public television stations. PBS uses noncommercial television, the Internet, and other media to provide programs and education services to nearly 100 million people each week.

The Ready-to-Learn Television program's purposes are the development of (1) educational programming for preschool and early elementary school children and their families; (2) educational television programming and printed materials to increase school readiness for young children in limited English proficient households and to increase family literacy; and (3) accompanying support materials and services that promote the effective use of educational television programming. The Department of Education awarded PBS a five-year \$80 million Agreement under this program. The PBS Agreement was for the period September 1, 2000, through August 31, 2005. For the September 1, 2000, through August 31, 2001, budget period, the Department of Education authorized funding of \$15,994,925. PBS charged \$11,478,218 to the Agreement.

The Agreement is authorized by the ESEA, as amended by the Improving America's Schools Act of 1994. It is subject to the provisions contained in 34 C.F.R. Part 74, *Administration of Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations* and OMB Circular A-122, *Cost Principles for Non-Profit Organizations*.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine if costs charged to the Agreement during the period September 1, 2000, through August 31, 2001, were allowable, reasonable, and allocable in accordance with the ESEA, Agreement terms, EDGAR, and the cost principles in OMB Circular A-122, effective June 1, 1998. Although we tested all cost categories, our testing emphasized (1) procurements, (2) travel, (3) advertising and promotional materials, (4) training seminars, and (5) equipment.

To accomplish our objective, we—

1. Reviewed the OMB Circular A-133 audit reports for the years ended June 30, 1999-2001, prepared by an independent public accountant, and the related working papers for the audit of the year ended June 30, 2001, and reviewed working papers prepared by PBS's internal auditor related to various issues, including procurements cash disbursements, and payroll.
2. Reviewed PBS's June 2, 2000, application and annual Agreement report for fiscal year 2000.
3. Reviewed written policies, procedures, and organization charts.
4. Reviewed procurements over \$25,000 and the related bid files.
5. Reviewed various records and documents, including accounting and payroll records, purchase orders, invoices, and other supporting documents for 137 financial transactions consisting of an initial sample of 37 randomly¹ and 6 judgmentally selected transactions from a universe of 2,969 transactions, and 93 transactions subsequently selected on a judgmental basis. The transactions subsequently selected consisted of all revenue (16), procurements (14), program acquisition (8), equipment (5), advertising (4), employee bonus (3), and employee relocation (1); and selected airline tickets (valued in excess of \$1,000 each) (11), business meals (25), and legal fees (6).
6. Interviewed various PBS employees, Department of Education personnel, and independent public accountant personnel.

To achieve our audit objectives, we relied, in part, on computer-processed data related to the Ready-To-Learn Agreement contained in PBS's accounting system. We assessed the reliability of these data, including the relevant general and application controls, and found them to be adequate. We verified the completeness of the data by comparing source records to computer generated data, verified the authenticity by comparing computer generated data to source records, and verified the accuracy by manually duplicating selected computer processes. Based on these tests and assessments, we concluded that the data were sufficiently reliable to be used in meeting the audit's objective.

¹ Results of the random sampling may not be representative of the entire population.

We conducted our fieldwork at PBS's administrative office in Alexandria, Virginia, from February 4, 2002, through April 4, 2002. We discussed the results of our audit with PBS officials on April 4, 2002.

Our audit was performed in accordance with government auditing standards appropriate to the scope of audit described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of our review, we did not assess the adequacy of PBS's management control structure applicable to the Agreement. Instead, we (1) gained an understanding of controls, policies, procedures, and practices related to travel, equipment, legal, procurements, advertising and promotional materials, training, salaries and fringe benefits expenses, cost allocations, and equipment, and (2) relied on substantive testing of costs charged to the Agreement. Our testing disclosed instances of non-compliance with federal regulations and cost principles that led us to believe weaknesses existed in PBS's controls over the Agreement. These weaknesses and their effects are discussed in the AUDIT RESULTS section of this report.

ADMINISTRATIVE MATTERS

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on the audit.

Grover J. Whitehurst, Assistant Secretary
Office of Educational Research and Improvement
U.S. Department of Education
Capitol Place, Room 600D
555 New Jersey Avenue, N.W.
Washington, D.C. 20208

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. § 552), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard J. Dowd", with a large, stylized flourish at the end.

Richard J. Dowd
Regional Inspector General
for Audit

Attachment

SCHEDULE OF COSTS RECOMMENDED FOR ACCEPTANCE, COSTS QUESTIONED, AND COSTS THAT ARE UNSUPPORTED

Cost Category	Costs Recommended For Acceptance	Costs Questioned	Costs Unsupported	Total Costs Charged to Agreement
Personnel	\$444,332	\$0	\$0	\$444,332
Fringe Benefits	116,749	0	0	116,749
Travel	142,751	48 (1)	1,122 (2)	143,921
Supplies/Services	170,248	0	0	170,248
Training	194,697	0	0	194,697
Professional Services	100,153	0	0	100,153
Equipment Lease	2,200	0	0	2,200
Software Acquisition	1,330	0	0	1,330
Promotions	395	0	0	395
Sub-Totals	\$1,172,855	\$48	\$1,122	\$1,174,025
Indirect Costs	0	4 (3)	93,927 (4)	93,931
Sub-Totals	\$1,172,855	\$52	\$95,049	\$1,267,956
Contractual	10,164,555	0	0	10,164,555
Equipment	92	0	0	92
Rent & Utilities	0	0	45,615 (5)	45,615
Totals	<u>\$11,337,502</u>	<u>\$52</u>	<u>\$140,664</u>	<u>\$11,478,218</u>

(1) Represents charges for alcoholic beverages. *OMB Circular A-122, Attachment B, Paragraph 2* (1998) states, "Costs of alcoholic beverages are unallowable."

(2) Represents costs of meals. PBS claimed the meals were served as part of business meetings. Meals as part of business meetings and conferences are allowable under *OMB Circular A-122, Attachment B, Paragraph 29, Subparagraph a* (1998). However, PBS did not provide support that business meetings were held, and business was conducted, when the meals were provided. According to *OMB Circular A-122, Attachment A, Paragraph A, Subparagraph 2.g.* (1998), to be allowable, costs must be adequately documented.

(3) Represents indirect costs related to questioned travel and other costs. We used the eight percent rate PBS used in lieu of an approved rate to calculate the unallowable amount.

(4) Includes \$90 of indirect costs related to unsupported travel costs. The remaining \$93,827 is unsupported because PBS did not have an approved indirect cost rate. *OMB Circular A-122, Attachment A, Paragraph E, Subparagraph 1.f.* (1998), defines an indirect cost proposal as, "...the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs...." According to *OMB Circular A-122, Attachment A, Paragraph E, Subparagraph 2.b.* (1998), "A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal immediately after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award." Department of Education

officials told us PBS had submitted an initial indirect cost proposal, then withdrew it and did not re-submit another proposal.

- (5) Represents rent and utility costs PBS allocated based on salaries. According to *OMB Circular A-122, Attachment A, Paragraph A, Subparagraph 4.a.* (1998), “A cost is allocable to a particular cost objective...in accordance with the relative benefits received....” Salaries are not necessarily representative of the space and utilities usage by an employee.



August 13, 2002

Richard J. Dowd
Regional Inspector General
for Audit
U.S. Department of Education
Office of Inspector General
111 N. Canal Street, Suite 940
Chicago, IL 60606

Dear Mr. Dowd,

Please find below our written comments on the findings and recommendations outlined in your **Draft Audit Report** dated July 15, 2002 for the Ready-To-Learn Cooperative Agreement No. R295A000002 (Agreement).

Finding No. 1 PBS Charged Costs to the Grant that are Unallowable or Unsupported

Management's Response: Management agrees that it must refund the Department of Education for unallowable costs of \$48 representing alcoholic beverages and the corresponding indirect cost of \$4.

The status of the unsupported costs of \$143,470 is addressed below using the same reference numbers as indicated in the Attachment to the Report.

- (1) Management has been able to provide after the fact documentation to support \$1,737 of salaries it charged to the Agreement. See Attachment A for a copy of the employee's time sheet for the period ended August 31, 2000. PBS pays its employees the pay period after services are provided. Therefore, salaries paid during the period ended September 15, 2000 are supported with attached time sheet for August 31, 2000.
- (2) Management disagrees that fringe benefits of \$482 related to salaries are unsupported. Salaries are supported, as are the related fringe benefits.
- (4) Management agrees that it was unable to provide support that business meals of \$219 were served as part of business meetings. This amount will be refunded to the Department of Education. However, management has support for business meals of \$1,494. The support for these costs is currently in archives. We will provide the support by the end of the week.
- (6) Management agrees that indirect costs of \$18 related to unsupported travel are also unsupported. This amount will be refunded to the Department of Education. However, management disagrees that the remaining indirect costs of \$297 related to personnel, fringe benefits and some travel are unsupported. Management has now supported these costs of \$3,713 and; therefore, has supported the related \$297 in indirect costs. Additionally, management disagrees that the remaining \$93,612 in indirect costs is unsupported due to PBS not having an approved indirect cost rate. Management submitted an indirect cost rate proposal to the Department of Education on April 24, 2002. The proposal substantiates an indirect cost rate of 12.35%--greater than the 8% indirect cost rate currently being applied to the Agreement. Management responded to follow-up questions by the DOE on July 31,

2002. Management anticipates we are only weeks away from establishing an approved indirect cost rate with the DOE that will be greater than 8% and; therefore, supports our use of the 8% indirect cost rate.

- (7) Management disagrees that rent and utility costs of \$45,615 may not necessarily be representative of the space and utilities usage by an employee. The methodology of allocating rent and utilities costs based on salaries was consistent with the method PBS used to allocate rent and utilities at the corporate level at the time the Agreement proposal was accepted. Since this time, PBS has changed its rent and utilities' allocation methodology at the corporate level to an allocation method based on budgeted headcount versus salaries charged. Management believes this is a reasonable distribution methodology because the average rent/utility expense is spread evenly to all employees. See Attachment B for an analysis that demonstrates that the allocation of rent and utilities based on budgeted headcount is materially consistent with results of an allocation based on square footage and thus a reasonable distribution of costs proportional to the Federal programs.

Based on the reasonableness of the analysis, beginning with the year 3 award for the Agreement, management will allocate rent and utilities to the Agreement based on budgeted headcount consistent with PBS's corporate allocation.

Finding No. 2 PBS Needs to Establish and Implement Written Policies and Procedures that Comply with the Standards for Financial Management Systems

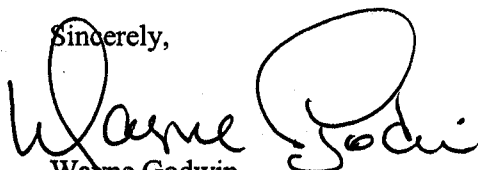
Management's Response: PBS developed and implemented written policies and procedures that comply with the standards for financial management. Please see Attachment C for a copy of the policy effective April 1, 2002. Grant and related staff were trained on the policy on April 5th.

Finding No. 3 PBS Needs to Revise Its Travel Policy

Management's Response: PBS revised its travel policy to ensure that it includes all applicable cost principles, including the prohibition of alcoholic beverages to be charged to Federal Grants. Please see Attachment D for a copy of the policy.

If you have any questions or if you wish to discuss any of our responses further, please contact me at 703-739-5440. Thank you for your time and consideration.

Sincerely,



Wayne Godwin
Executive Vice President &
Chief Operating Officer



August 15, 2002

Richard J. Dowd
Regional Inspector General
for Audit
U.S. Department of Education
Office of Inspector General
111 N. Canal Street, Suite 940
Chicago, IL 60606

Dear Mr. Dowd,

As promised in Wayne Godwin's letter to you dated August 13, 2002, we have enclosed supporting documentation for the travel costs (meals) of \$1,494 for the Ready-To-Learn Cooperative Agreement No. R295A000002. Behind this letter is the detail of meals we have support for, some additional information explaining each expense, and the supporting documentation.

Again we appreciate your time in considering this additional support. If you have any questions or if you wish to these materials further, please contact me at 703-739-5079. Thank you for your time.

Sincerely,

Denise M. Wise

Denise Wise
Controller & Assistant Treasurer